

M e m o r a n d u m

Date: March 11, 2009

To: Office of the Commissioner
Attention: Commissioner J. A. Farrow

From: **DEPARTMENT OF CALIFORNIA HIGHWAY PATROL**
Office of Assistant Commissioner, Inspector General

File No.: 005.9968.A14654.A13708.010

Subject: FOLLOW-UP REVIEW OF THE 2007 CONTRACTS AUDIT

On July 3, 2006, the Office of the Commissioner directed the Office of Internal Affairs, Audits and Evaluation Unit, (reorganized under the Office of Inspections, Audits Unit) to perform an audit of the contracts and purchase orders based upon multiple inquiries regarding the California Highway Patrol's (Department) procurement process. The scope of the audit was all contracts and purchase orders for the previous three fiscal years (FY) 2003/04, FY 2004/05, and FY 2005/06).

The primary objective of the audit was to provide Executive Management with an assessment of departmental procurement processes. It was also used to determine procedural compliance with departmental policies and adherence to state laws and regulations. The results of the review were presented in the 2007 Contracts Audit final report issued September 7, 2007.

A follow-up review was conducted from July 29, 2008 - August 6, 2008. The objective of this follow-up audit was to determine if the Department has implemented the corrective actions indicated in their response to the 2007 Contracts Audit final report. The follow-up review focused on available documentation to evaluate progress.

It should be noted that the Department has implemented the corrective actions identified in the 2007 Contracts Audit final report. The Office of Inspections validated the corrective work would adequately address the identified weaknesses. Hence, this review indicates successful completion of all required activities. Since corrective actions have been taken on the recommendations, this report represents the close-out of the 2007 Contracts Audit final report.

Office of the Commissioner

Page 2

March 11, 2009

We appreciate the courtesy, cooperation, and assistance extended to Office of Inspections by the Administrative Services Section. If you have any questions, please contact Roger Ikemoto, Senior Management Auditor at (916) 451-8405.



M. C. A. SANTIAGO
Assistant Commissioner

Attachment

cc: Office of the Assistant Commissioner, Staff
Administrative Services Division
Office of Inspections, Commander
Office of Inspections, Audits Unit

CONTRACTS AUDIT FOLLOW-UP AUGUST 2008

On June 13, 2008, the Office of Assistant Commissioner, Inspector General, sent a memorandum to Administrative Services Division (ASD) requesting a response to the 2007 Contracts Audit final report. The memorandum also mentioned that the Office of Inspections, Audits Unit, would be following up on the 2007 Contracts Audit and would be requesting documents based on ASD's response to the audit findings.

The Office of Inspections, Audits Unit, started the follow-up review on July 29, 2008. Prior to the audit staff's arrival, a request for the populations of all contracts, purchase orders, and X Number contracts issued for the period of January 1, 2008 to June 30, 2008, was submitted to ASD. ASD was instrumental in taking proactive steps to clear the audit findings of the 2007 Contracts Audit.

This follow-up review consisted of assessing the corrective actions completed, as documented in the response memorandums dated January 23, 2008 and June 23, 2008. The Office of Inspections, Audits Unit, reviewed:

- Contracts from January 1, 2008 to June 30, 2008
- Purchase orders from January 1, 2008 to June 30, 2008
- X Number contracts from January 1, 2008 to June 30, 2008
- Claim schedules containing the accompanying vendor invoices associated with the reviewed files

Finding 1:

The Department incorrectly used "Fair and Reasonable Pricing".

Condition:

The California Highway Patrol (Department) erred when it used historical pricing, which is one of five fair and reasonable pricing techniques, as the basis for certain purchases of less than \$5,000. During the vendor selection and award process for purchase orders, this concept allows for obtaining one quote and comparing that quote to a previous transaction (within the last 18 months), for a similar commodity, and without exceeding a fifteen percent cost increase. However, when the historical transaction was traced, the historical price was found to have been incorrectly awarded. The following errors also contributed and in themselves would have invalidated the transaction:

- The Department improperly combined two different procurement methods (small business incentive preference and leveraged procurement) when determining vendor selection. The error with mixing different methods is each method has its own set of rules. For example, the small business incentive preference, a five percent

deduction to the small business quote, is not applicable to the leveraged procurement method.

- When the fair and reasonable pricing techniques are applied, the transaction is not eligible for the five percent small business incentive preference.
- The original historical transaction was more than 18 months old.

Due to the varied costing models used (i.e., departments pay Department of General Services (DGS) for using the leveraged procurement but not the competitive procurement method, which include small business transactions, and the five percent incentive preference), a cost savings or increase cost was not calculated. Note: for award consideration purposes, the five percent incentive preference reduces the quoted price; however, the quoted price is used for payment purposes. Also, the leveraged procurement price schedule is the maximum that may be charged, but the vendor may quote a lower price.

Criteria:

1. Purchasing Authority Manual (PAM) Chapter 2, Procurement Planning, Section 2.B2.0, requires a decision on the procurement method (competitive, non-competitive, exempt, or using one Leveraged Procurement Agreements (LPA) programs).
2. PAM Chapter 3, Socioeconomic and Environmental Programs, Section 3.4.0, cites an exception to the small business preference: "The SB preference is not applicable when the solicitation is being conducted using the 'SB/DVBE [small business/disabled veteran business enterprise] Option' procurement approach or if the acquisition is less than \$5,000.00 and price has been documented to be fair and reasonable."
3. PAM Chapter 4, Competitive Solicitations, Section 4.C2.0, states if the estimated value of a transaction is less than \$5,000, buyers shall obtain at least two price quotations whenever there is reason to believe that one response from a single source is not a fair and reasonable price. The five methods for determining fair and reasonable pricing are: 1) price comparison, 2) catalog or market pricing, 3) controlled pricing, 4) historical pricing, and 5) cost/benefit analysis.
4. California Multiple Award Schedule (CMAS) Services Guide dated January 2003, further clarifies CMAS (leveraged) transactions are not competitive bid transactions so small business preference, protest language, intents to award, evaluation criteria, advertising, etc. are not applicable.

Auditee Response:

1. As a result of the finding, which indicated the Department was not correctly applying the methods for determining fair and reasonable pricing, the Business Services Office has examined the training needs for procurement staff. A matrix that identifies the proposed training by classification has been developed which will assist in ensuring staff are provided the skills and knowledge necessary to be successful in their position.

2. ASD has developed a training course for procurement officials and approvers designed to give attendees a basic understanding of their role in the procurement of goods and services. Additionally, attendees will be provided specific information which will be beneficial during the review and/or approval of procurement documents. The initial training was held in April 2008 with additional classes scheduled in July and October 2008. A version of this training has also been presented or is scheduled to be presented at various Division Area Commanders' Conferences which allows the course material to be offered directly to the recipients at a time and place convenient to them.

3. In addition to the above, ASD, via the Office of the Commissioner, received confirmation from DGS that ASD was in fact using the historical pricing technique correctly. However, ASD will continue to avail itself of all applicable training to strengthen its procurement practices.

Auditor Observation:

There was no indication of an incorrect use of fair and reasonable techniques in the purchase order files reviewed by audit staff.

Additionally, ASD has developed and held training courses for those involved in the procurement process.

Auditor Conclusion:

Fully implemented.

FINDING 2:**The Department obtains services prior to approval of the contract.****Condition:**

The contract review revealed services, although not deemed emergency, were started prior to the execution or issuance of the contract. Specifically,

1. Contracts: Twenty percent of the contract files reviewed (seven from fiscal year (FY) 2003/04; 11 from FY 2004/05; and 21 from FY 2005/06) revealed services commenced prior to the execution of the contract by both parties.

2. X Number contracts: Sixty-three percent of ASD's X Number contract files reviewed (37 from FY 2003/04; 49 from FY 2004/05; and 58 from FY 2005/06) revealed services or commodities were obtained prior to the X Number contract approval. Additionally, eighteen percent of ASD's X Number contract files reviewed (17 from FY 2004/05 and 24 from FY 2005/06) indicated Division offices issued X Number contract numbers after the services were performed without the appropriate Assistant Commissioner's approval.

Criteria:

1. State Contracting Manual (SCM) Section 2.03 states, "When the services are needed is a critical factor. Sufficient time must be allowed for internal agency process as well as required external review(s)."
2. SCM Section 3.10 states, emergency is defined in Public Contracting Code (PCC), Section 1102, as "a sudden, unexpected occurrence that poses a clear and imminent danger, requiring immediate action to prevent or mitigate the loss or impairment of life, health, property, or essential public services."
3. Comm-Net message date November 8, 2004, required all contracts, where service started prior to X Number contract issuance, must be forwarded to the appropriate Assistant Commissioner for resolution. This information has not been updated to departmental policy and is currently expired.
4. Highway Patrol Manual (HPM) 11.1, Administrative Procedures Manual, Chapter 23, Delegation of X Number Contract Authority, Section 2, paragraph A, states in part that obtaining an X Number after services are rendered is prohibited.

Auditee Response:

1. To correct this abnormality, ASD has developed various reports to assist the contract manager in monitoring contract activity. These reports include aging reports by start date and reports to identify open and closed one-time service contracts. The "late pending" report is used to identify those contracts having the possibility of not being signed prior to the start date. This report became available in August 2006, and is published monthly. Finally, ASD has developed policy for contract renewal purposes, to notify the Office of Primary Interest (OPI), at least seven months prior to contract expiration. This report is sent out to all OPI's each month and was implemented in May 2006.
2. As a result of the finding stating that services were started prior to the execution or issuance of a contract, ASD instituted a number of changes designed to update policy and assist staff in monitoring contract activity.

3. HPM 11.1, Administrative Procedures Manual, Chapter 22, Service Contracts/Letters of Agreement, was revised in June 2008, in compliance with SCM 2.03, which states, "When services are needed is a critical factor, sufficient time must be allowed for internal agency process as well as required external review(s)." Chapter 22 provides the required timeframe needed to ensure contract completion before work has commenced and states work cannot be started until the contract is executed and approved. A Comm-Net message was issued March 18, 2008, that also states those requirements.

4. As indicated in the recommendation contained in Finding 2, ASD has developed reports designed to assist the contract manager in monitoring contract activity. The late pending report, which became available in August 2006, is used to identify contracts in danger of not being signed by the start date. In addition, the OPI is notified at least seven months prior to contract expiration.

5. HPM 11.1, Administrative Procedures Manual, Chapter 23, Designation of X Number Contract Authority, has been undergoing a review and is being updated with new procedures. A new automated process will allow the electronic submission of the X Number Log to expand the oversight and review of the X Number Contract Authority and assist in targeting problem Areas and/or commands that may be in need of additional training or scrutiny.

Auditor Observation:

Two of 10 contract files reviewed by the auditors had final approval and execution dates after the start date of the contract. However, upon review of the accompanying vendor invoices from these and the remaining contracts, there was no indication as of the date the review was conducted that services were rendered prior to the final approval or execution dates of the contracts.

All 10 of the X Number contract files reviewed had services performed subsequent to the request date for the X Number.

Auditor Conclusion:

Fully implemented.

FINDING 3:

Purchase order splitting.

Condition:

Multiple purchase order files for tires from the same vendor were observed during the same fiscal year. Of the 872 purchase orders sampled, 115 purchases were for tires (49 from FY 2003/04; 39 from FY 2004/05; and 27 from FY 2005/06), totaling \$428,437. Additionally, one vendor obtained 15 purchase orders totaling \$40,001

for FY 2003/04; 17 purchase orders totaling \$59,294 for FY 2004/05; and eight purchase orders totaling \$39,129 for FY 2005/06.

Multiple purchase order files were observed for tire changers and wheel balancers for different Area offices during the same fiscal year. One of the two price quotations for the tire changers and wheel balancers specifically states the pricing is for a minimum of 30 units. This annotation demonstrates fore knowledge of a potential bulk order destined to multiple Area offices throughout the state. Furthermore, of the 872 purchase order sampled, six purchase orders were for tire changers and wheel balancers, awarded to one vendor, during FY 2005/06 totaling \$32,325.

Criteria:

1. PCC, Section 10329, states, "No person shall willfully split a single transaction into a series of transactions for the purpose of evading the bidding requirements of this article."
2. PAM, Chapter 1.3.5, states, "Departments also may not split orders to circumvent approved purchasing authority thresholds." [Department purchasing authority for competitive procurement method is \$50,000]
3. State Administrative Manual, Chapter 1215, Section 4E, prohibits the splitting of contracts to avoid monetary limitations.

Auditee Response:

This finding is related primarily to the purchase of tires and the ASD recent information that the Western States Contracting Alliance (WSCA) tire contract had been renewed through March 1, 2009. ASD had been working with DGS to develop a tire protocol to procure a statewide tire contract which would ensure a tire contract would be in place beyond March 2009, but DGS recently informed the Department that a tire contract would not be needed because it is expected the WSCA will be extended beyond 2009 and the contract will include provisions for the procurement of high speed pursuit tires. This action provides the Department with a known source and supply of tires for an extended period of time. In the event WSCA is not renewed sometime in the future, DGS will expedite the processing of a one time purchase and/or establish a statewide Masters Service Agreement contract for tires that includes high speed pursuit tires. The WSCA provides a vehicle where staff can procure tires on an as-needed basis to be delivered to Area offices statewide.

Auditor Observation:

There was no indication of purchase order splitting based on the purchase order files reviewed for this audit follow-up.

Auditor Conclusion:

Fully implemented.

FINDING 4:**Invoices paid without proper authorization.****Condition:**

Contract invoice files lacked authorization approval from the OPI in 62 instances (52 from FY 2003/04; eight from FY 2004/05; and two from FY 2005/06). Purchase order invoices lacked OPI approval in 284 instances (16 from FY 2003/04; 140 from FY 2004/05; and 128 from FY 2005/06). X Number invoice files lacked authorization approval from the OPI in two instances (two from FY 2003/04).

Criteria:

HPM 11.1, Administrative Procedures Manual, Chapter 24, Payment of Invoices, requires the commander's or his/her designee's signature approval, identification number shall be on the invoice.

Auditee Response:

In November 2007, a Management Information System notification was released to commands reminding them of existing policy relative to the review and approval of invoices. In December 2007, ASD reviewed the desk procedures to ensure compliance with Department and state policy.

Auditor Observation:

During the review of invoices associated with the contracts, purchase orders, and X Number contracts reviewed as part of this follow-up, each invoice was properly authorized in accordance with policy.

Auditor Conclusion:

Fully implemented.

FINDING 5:**Contract and purchase order files not available.****Condition:**

1. Contract Services Unit (CSU) was unable to produce seven of 200 contract files (four from FY 2003/04; two from FY 2004/05; and one from FY 2005/06).
2. CSU was unable to produce 10 of 140 Headquarters generated X Number contract files (six from FY 2003/04; two from FY 2004/05; and two from FY 2005/06).
3. Purchasing Services Unit was unable to produce 79 of 872 purchase order files (45 from FY 2003/04; 14 from FY 2004/05; and 20 from FY 2005/06).
4. Some of the eight field Division offices, and CSU, which has oversight of the X Number contracts, were unable to produce X Number contract files or X Number logs for Division issued X

Numbers. Field Division offices were unable to produce 20 of 228 X Number contract files (five from FY 2003; nine from FY 2004; and six from FY 2005).

Criteria:

1. HPM 11.1, Chapter 22, Service Contracts/Letters of Agreement, states contract files must be maintained by the OPI.
2. HPM 11.2, Chapter 7, is silent regarding purchase order record retention.
3. PAM, Chapter 11.4.2, Record Retention Requirement, states, "Departments are reminded of the examination and audit requirements as described in Government Code section 8546.7 and identified in the General Provisions (both non-IT goods and IT goods and services) language requiring transaction documentation to be retained...."

Auditee Response:

ASD has limited access to its contract and purchasing files to its staff. External staff requesting contract and/or purchase order files are accompanied by ASD staff. External staff do not remove and/or re-file any files without ASD staff.

Additionally, in July 2007, managers began reviewing the contract and purchase order files for proper documentation at the time of signature (self-inspection). On an ongoing basis, unresolved discrepancies are reported to Assistant Commissioner, Staff.

Auditor Observation:

All contract and X Number contract files were readily available for review. Access to the contracts and X Numbers contract files remain secure in a locked room. One of the 10 purchase order files could not be located and was not made available for review. Although the one exception occurred after ASD implemented its restricted access procedures to all contract and purchase files, the Audits Unit determined this one exception was an anomaly to the overall purchasing file population and not representative of the entire population. Additionally, based on the small sample selected with a small exception rate and the proactive procedures implemented, the Audits Unit determined this one exception to be immaterial to the overall process.

Auditor Conclusion:

Fully implemented.

FINDING 6:

File documentation not complete.

Condition:

1. Fifteen of 200 contract files were missing documentation supporting CSU advertised the contract for bid in the California State Contracts

Register (four from FY 2003/04, 10 from FY 2004/05, and one from FY 2005/06).

2. Twenty-eight of 872 purchase order files were missing documentation to support purchase quotations (12 from FY 2003/04; four from FY 2004/05; and 12 from FY 2005/06). Forty-three purchase order files lacked certification of SB/DVBE (28 from FY 2003/04; 12 from FY 2004/05; and three from FY 2005/06).

3. Sixty-five percent of X Number contract files did not contain the Drug Free Workplace certification and/or Payee Data Record documentation, (78 from FY 2003/04, 71 from FY 2004/05, and 92 from FY 2005/06).

Criteria:

1. SCM Section 9.09 states: "...each agency is responsible for maintaining all invoices, records, and relevant documentation."

2. PAM, Chapter 11, Section 4, requires transaction documentation to be retained.

3. HPM 11.1, Administrative Procedures Manual, Chapter 23, Delegation of X Number Contract Authority, states the original STD. 21, Drug-Free Workplace Certification, and the STD. 204, Payee Data Record Form, must be retained in the originating command files for audit purposes.

Auditee Response:

1. Checklists were implemented in May 2007 to ensure file documentation is complete. As noted above in Finding 5, managers self-inspect each (contract and purchase order) file at the time of signature. Any missing documentation is required prior to approval of the procurement document.

2. ASD will conduct an independent inspection of the contract and purchase order files no later than March 2008. The independent inspection will consist of randomly selected on-site contract and purchase order files (sample size to be determined). The files will be checked to ensure they contain proper documentation as outlined by the appropriate checklist. A summary of findings will be forwarded to Assistant Commissioner, Staff no later than April 1, 2008.

Auditor Observation:

Contract, purchase order, and X Number contract files contained the required documentation. The audit staff observed the appropriate checklists were used and contained within each file.

Auditor Conclusion:

Fully implemented.

The Department implemented corrective actions identified in the 2007 Contracts Audit final report. As part of the follow-up review, the Office of Inspections, Audits Unit, held discussions with the parties involved concerning the specific actions taken to implement recommendations from the initial audit. This was supplemented by an examination of records. A review of the documents disclosed the Department implemented corrective actions. The Office of Inspections, Audits Unit, validated the corrective work adequately addressed the weaknesses identified in the audit report. Hence, this review indicates successful completion of all required activities. Since corrective actions have been taken to adequately resolve the findings, this report represents the close-out of the 2007 Contracts Audit.